No. 18245

In the

United States Court of Appeals

for the Ninth Circuit

ANGUS J. DE PINTO, HJALMAR B. LANDOE FRANCIS I. SABO and EDWIN B. PEGRAM, ELMER W. DUHAME,

Appellants,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and JOHN S. GORSUCH and ALBERT J. DOIG,

Appellees.

Reply Brief of Appellants Francis I. Sabo and Edwin B. Pegram

On Appeal from the United States District Court for the District of Arizona

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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INTRODUCTION

With the voluminous record and numerous briefs already filed in this matter, including the prior appeal in No. 17114, we shall make every effort to avoid unnecessary repetition in this closing brief. However, we do wish to emphasize once again the significant distinctions between the remaining parties.

There has been a tendency, both on the part of Appellees and of the District Court, to attribute to all of the Defendants the errors and defalcations of each of them. Where there is no factual or legal support for such grouping, the unfortunate result has been to penalize the innocent along with the guilty. Now the brief of Appellees is replete with references to alleged irresponsibility or misconduct of some of the Defendants and their Attorneys. We therefore ask the Court, in reviewing the arguments and accusations made by Appellees, to note with particular care the parties to whom they properly apply.

SUMMARY OF ARGUMENT

1. Nothing could have been done by Sabo or Pegram after October 18, 1957, which would have prevented or minimized loss to United by reason of the asserted diversion of assets (Referring to Pages 102 and 103 of Appellees' brief).

2. There is no basis in the Findings of Fact or Conclusions of Law, or in the law or the evidence, for imposition of liability upon Sabo and Pegram for breach of a fiduciary duty owed by them to United as controlling shareholders on October 18, 1957 (Referring to Pages 84 through 87 of Appellees' brief).

3. Neither Sabo nor Pegram had, or should reasonably have had, any knowledge of their election as Directors of United on October 18, 1957, or of any improprieties in the transactions which occurred on that date (Referring to Pages 103 through 107 and to Pages 87 through 102 of Appellees' brief).

4. Neither Sabo nor Pegram is liable to United as a Director of American on October 18, 1957, for:

a. Knowing participation with fiduciaries in the breach of fiduciary duties (Referring to Pages 87 through 97 of Appellees' brief); or

b. Negligence in failing to supervise the activities of the other Officers and Directors of American on that date (Referring to Pages 97 through 102 of Appellees' brief).

5. Neither DePinto nor Duhame is entitled to contribution or indemnity from Sabo or Pegram with regard to any recovery had against them in this action (Referring to Pages 37 and 38 of the brief of Appellant DePinto).

ARGUMENT

1. Nothing Could Have Been Done by Sabo or Pegram After October 18, 1957, Which Would Have Prevented or Minimized Loss to United by Reason of the Asserted Diversion of Assets (Referring to Pages 102 and 103 of Appellees' brief).

In remanding this action for further proceedings, this Court requested a further finding by the District Court with regard to what action, if any, Appellants Sabo and Pegram could have taken in November or December, 1957, "which would have prevented or minimized loss to United by the reason of the asserted diversion of assets." *(Niesz v. Gorsuch,* No. 17114; 295 F. 2d 909, 914) The response of the District Court is, quite clearly, "Nothing."

There has been no evidence whatever that any action which might have been taken by Sabo or Pegram after October 18, 1957, would have been at all effective in preventing or minimizing the loss. The District Court found, in its Supplemental Finding 24 (Tr. 1728):

> "* * * After October 18, 1957, had passed, and the loss had occurred, none of the Defendants could take action which would prevent the loss which had already occurred."

As Appellees apparently acknowledge in their brief, the relevant question now is whether Sabo and Pegram were under any duty to United *on or before October 18, 1957,* the due performance of which would have prevented or minimized the irrevocable loss which then occurred. It is conceded, of course, that the loss could have been prevented by the simple expedient of refusing to make the offer to United, or refusing to advance any funds to American. The question remains whether Sabo and Pegram were under any duty in this regard.

At any rate, it has now been conclusively established that the only relevant period for purposes of considering any such duties was that which ended with the transfer of the assets to Kelly at about 5 p.m., October 18, 1957.

2. There Is No Basis in the Findings of Fact or Conclusions of Law, or in the Law or the Evidence, for Imposition of Liability Upon Sabo and Pegram for Breach of a Fiduciary Duty Owed by Them to United as Controlling Shareholders on October 18, 1957 (Referring to Pages 84 through 87 of Appellees' brief).

Appellees attempt now, for the first time, to bring Sabo and Pegram in under the controlling shareholders theory, as expounded in *Consolidated Rock Products Co. v. DuBois,* 312 US 510, 61 S. Ct. 675 (1941). The District Court did not purport to find Sabo and Pegram liable on this theory with regard to the events of October 18, 1957, for the very obvious reason that at the time United accepted the offer and transferred its assets to American in exchange for the latter's stock, *neither they nor American had any* stock interest in United. That the District Court did not so intend is perfectly clear from a full reading of its Supplemental Conclusion 13, portions of which are quoted out of context on Pages 85 and 87 of Appellees brief.

"S.C. 13: Sabo, Pegram and Landoe not only assisted Kelly in breaching the fiduciary duty he owed to United and to the minority shareholders by reason of his owning a controlling interest, but, also, assisted Croydon, Niesz, and Ballantyne in breaching the fiduciary duties they, respectively, owed United as directors of United. Consequently, Sabo, Pegram and Landoe are liable for having assisted a fiduciary breach his duties as well as having themselves breached the fiduciary duty they owed to United by reason of being directors of American." (Tr. 1739)

If one fact has been entirely undisputed throughout this litigation, it is that Kelly was in control of United at all relevant times. Kelly consistently manipulated the various Boards of Directors, and it was Kelly who prompted the corporate action taken by United on October 18, 1957, and accepted the offer made by American. The fact of Kelly's control was stipulated in the pre-trial order (Tr. 236; Paragraphs 48 and 49), was reaffirmed in the original Findings of Fact (Tr. 334-335; Findings of Fact 10 and 13), and Conclusions of Law (Tr. 350-351; Conclusions of Law 14 and 15), and was stated once again in Supplemental Finding 25 (Tr. 1728) and in Supplemental Conclusion 13 above quoted.

The domination of Kelly necessarily continued until such time as he finally endorsed and delivered his stock in United to American at the end of the day on October 18, 1957 (Exhibit 58; Tr. 662). Certainly Niesz, Croydon, and Ballantyne, owning and representing no stock in United, would not long have remained on the Board of Directors of that corporation if at the 4:15 p.m. meeting on October 18, 1957, they had refused to do Kelly's bidding by transferring the assets to American in exchange for the stock.

Nowhere in the Findings and Conclusions is there any reference to Sabo and Pegram as having any stock control over United at the time of its wrongful action. Any such finding or conclusion would be directly contrary to all of the evidence. Supplemental Finding 26 cannot reasonably be construed to include such a finding. Supplemental Finding 26 states as follows:

> "SF 26: Sabo, Pegram, Landoe, on October 18, 1957, owed a fiduciary duty to United by reason of their being Directors of American." (Tr. 1728)

This conclusory finding does not appear to be in compliance with requirements of Rule 52(a), Federal Rules of Civil Procedure, and with the holding of this Court in *National Lead Co. v. Western Lead Products Co.,* 291 F. 2d 447 (1961), wherein it stated at Page 451:

> "It is the duty of the District Court to find the facts. Rule 52(a), Federal Rules of Civil Procedure, 28 U.S. C.A. The findings should be so explicit as to give the appellate Court a clear understanding of the basis of the trial Court's decision, and to enable it to determine the ground on which the trial court reached its decision. See *Welsh Co. of California v. Strolee of California,* Supra.
>
> "It is not the proper function of this Court to engage in a process of assuming basic findings of fact upon which the conclusions of the District Court may have been reached, and then testing these assumed fact findings under the clearly erroneous provisions of Rule 52(a)."

We understood the finding, such as it is, to relate to either or both the alternative grounds advanced by Appellees and expressly adopted by the District Court, both of which are discussed herein under Section 4 of this brief. Upon this understanding, we presented our argument at

pages 28 to 48 of our opening brief, to the effect that the finding was based upon an erroneous view of the law and was contrary to the weight of the evidence. We still so contend, and we assert that, in their argument at pages 84 to 87 of their brief, Appellees are reading into this finding something which simply is not there. Since it has been established that, upon receipt of the assets by Kelly, the loss was complete, the control which American might thereafter have exercised over United has no relevance to this litigation.

The question of control is inseparable from the issue of knowledge, which will hereafter be discussed. Potential control over a corporation by reason of stock ownership is of no significance until such time as the dominant shareholder becomes aware of his position and takes advantage of his power. It is only the *abuse* of control, not its mere possession, which subjects one to liability as a fiduciary.

Nothing in *Consolidated Rock Products Co. v. DuBois*, or in any other decision cited by Appellees, would extend the fiduciary duty therein described to directors of the controlling corporation simply by virtue of their status as directors. Since there is no basis in the findings or conclusions for Appellees' assertion that Sabo and Pegram, acting through American, controlled the corporate actions taken by United on October 18, 1957, the argument at pages 84 through 87 of Appellees' brief is not well taken.

3. Neither Sabo nor Pegram Had, or Should Reasonably Have Had, Any Knowledge of Their Election as Directors of United on October 18, 1957, or of Any Improprieties in the Transactions Which Occurred on That Date (Referring to Pages 103 through 107 and to Pages 87 through 102 of Appellees' brief).

In spite of some suggestions to the contrary, we do not suppose that Appellees seriously contend that Sabo and

Pegram, in Montana on October 18, 1957, can be held vicariously liable in this action unless they had some knowledge, actual or constructive, of the events which occurred in Phoenix on that date and of the legal relationships which purportedly arose out of those events.

We have contended throughout that there is no competent evidence to support the findings that Sabo and Pegram had or should have had knowledge of any of these matters. Appellees have failed to support the affirmative of these propositions. The full extent of Appellees' compliance with Rule 18(3) of this Court is indicated by the following table, which sets forth each reference to the record or to exhibits made by Appellees in their response to our opening brief.

Testimony:

Sabo: Tr. 825; 835-842; 847; 852; 865-869; 876-880; 894; 906; 914-916.

Landoe: Tr. 1108.

Albert B. Turner: Tr. 762.

Exhibits:

101	Telegram, October 14, 1957 (Set forth in full as Appendix A to our opening brief herein)
F-12	Letter, October 22, 1957
F-13	Letter, November 5, 1957
50-A	American preincorporation agreement
50-N	American minutes, October 18, 1957
50-P	American minutes, November 18, 1957
D-1 and F-8-1	Tape and transcript of American meeting, February, 1958
5-G	United minutes, 4:00 P.M., October 18, 1957
5-H	United minutes, 4:15 P.M., October 18, 1957 (Set forth in full as Appendix B to our opening brief in No. 17114)

We shall not attempt to analyze here the twenty-six pages selected by Appellees from the testimony of Dr. Sabo. A careful examination of these references will afford no basis for Appellees' assertion either that Sabo actually admitted knowledge of his supposed involvement in the transaction or that he was lying when he denied such knowledge. The answer given by him at Page 876 of the Transcript, to the effect that he knew at the time of the preorganization meeting of American that he was to be a Director of United, was clearly and simply a mistake. Sabo's immediate correction of this error (Tr. 877), taken together with all his other testimony, as well as the statements of all others concerned (see pages 18 through 27 of our opening brief herein, together with pages 4 through 6 of our reply brief in No. 17114), must establish conclusively that the admission relied upon by Appellees is without probative value. Appellees have yet to specify the "testimony of Pegram, and others, and certain exhibits," referred to in Supplemental Finding 29; and certainly no great weight can be given to Dr. Sabo's demeanor in branding him a liar two years after he testified.

The cited testimony of Sabo does not support the challenged findings.

As for the testimony of Landoe, at Tr. 1108, it adds nothing of significance. Landoe merely relates his receipt of the telegram of October 14, 1957, and states that he explained it to Dr. Sabo, "To the best of my ability." (Tr. 1108)

The reference to the testimony of Turner, the witness from the First National Bank of Arizona, at Page 762 of the record, seems to be intended to support the implication that Sabo's transmittal of $52,000.00 on October 18, 1957, showed that he knew more of the events of that date than he admitted. Appellees would attach some dark significance

to the fact that $52,000.00 arrived from Sabo on the very day of the exchange. We are not told, however, how Sabo might have learned that October 18th would be the crucial date. Certainly none of the participants informed him. They were not aware themselves until that morning that the transaction would close that day (Tr. 718-719).

Appellees seem to have become confused with regard to the funds received by American from Sabo. On page 91 of their brief the statement is made that "he had advanced only $52,000.00 to American through October 18, 1957," while on the following page we are told that on October 18, 1957, American's "only assets were those purchased with the $23,000.00 sent by Sabo prior to October 17, 1957." The facts, as shown by the record, are that $40,000.00 was sent by Sabo to Croydon prior to October 17, 1957 (Tr. 924-925); $52,000.00 was received on October 18, 1957; and the final $23,000.00 of Sabo's $115,000.00 investment was sent on October 28, 1957 (Tr. 762-763). Although the relevance of these facts is doubtful, this is a correct statement of the record.

Of the eight (8) exhibits mentioned by Appellees and set forth in the table above, all but the first are of questionable relevancy, for reasons as follows: Exhibit F-12 is a letter, dated October 22, 1957, when, as the District Court found, nothing could have been done (Supplemental Finding 24); the letter makes no mention of directorships in United. Exhibit F-13 is another letter, dated November 5, 1957, from Croydon to Landoe, as to which all of the above also applies. Exhibit 50-A is a preincorporation agreement for American which contains no reference whatever to United or to the matter of directorships in any corporation other than American. Exhibit 50-N is the minutes of a director's meeting purportedly held by American on October 18, 1957,

when both Sabo and Pegram were in Montana, wherein it was resolved that the offer of shares would be made to United; there is no indication of who controlled United or who were its directors. Exhibit 50-P is the minutes of a later meeting of the American Board, purportedly held November 18, 1957; Sabo was not present. Exhibits D-1 and F-8-1 are a tape recording and transcript of an American meeting held in February, 1958, to discuss commissions paid to Croydon. Exhibits 5-G and 5-H are minutes of the critical meetings of the United Board, held October 18, 1957, at 4:00 p.m. and 4:15 p.m. It is undisputed that neither Sabo or Pegram ever saw or signed these minutes (Tr. 876-877).

Exhibit 101, to which Appellees have referred on Pages 90, 91, and 105 of their brief, is without question the most significant item in evidence regarding the liability of Sabo and Pegram. This is the telegram, dated October 14, 1957, sent by Niesz, Ballantyne, and Croydon to Landoe to outline the proposed transaction with United. It is set forth in full as Appendix A to our opening brief herein.

The record is entirely clear that this telegram embodied all that Sabo and Pegram knew of the United proposal prior to October 18, 1957, or for some time thereafter. This telegram was the first notice to Sabo or Pegram of the existence of United, although Landoe had had a telephone conversation on this subject with Croydon on the preceding day.

Appellees have relied on Exhibit 101 to support all of the critical findings made and inferences drawn by the District Court as to the actual or constructive knowledge of Sabo and Pegram on or before October 18, 1957. For this reason, we ask that the Court examine the Exhibit carefully. Under these circumstances, we submit that the weight

to be given this evidence is a matter peculiarly susceptible to appellate review. Since Sabo and Pegram had no previous knowledge of the transaction, their entire understanding during the relevant period is limited to that which is contained in, or reasonably inferred from, this document. If the sequence of events which actually did occur on October 18, 1957, is not clearly described or fairly inferable from this telegram, then the judgment entered against Sabo and Pegram must be reversed.

Appellees' analysis of Exhibit 101 has taken the following course. After discussing the telegram on Pages 91 and 92 of their brief, they state their position as follows:

> "Certainly both Sabo and Pegram, and Landoe were and are well aware that neither United nor any other corporation, dealing at arm's length and in the hands of those looking out for United's interests, would permit United to transfer $314,794.19 of its cash, bonds, and other liquid assets for 349,000 shares of stock in American, a corporation which had been formed at 4:45 P.M. the previous day and whose only assets were those purchased with the $23,000 sent by Sabo prior to October 17, 1957."

Then, at Page 95, they inquire:

> "* * * can it reasonably be concluded that educated and experienced men such as Sabo, Pegram and Landoe, a lawyer, who advised the former, did not have knowledge that Croydon, Niesz and Ballantyne, *as directors of United owed* a fiduciary duty to United and that such a duty would be breached if they actually did what they said they were going to do in the telegram of October 14, 1957?" (Emphasis supplied.)

And at Page 106, they conclude:

> "* * * Thus, he knew that since he was the only person putting money into American, the assets of United

would have to be taken by American acting through its directors, who were to be directors of United."

Thus, simply by rhetoric, Appellees have first bridged the gap from the bare words of the telegram to the assumption that Sabo and Pegram must have been "well aware" on October 14, 1957, that antagonistic forces had control of United; then from this to the further assumption that these antagnostic forces were none other than Croydon, Niesz, and Ballantyne; and then on to the final conclusion that Sabo and Pegram, on October 14, 1957, must have known that the Board of United would, on October 18, 1957, be composed of Directors of American, who would proceed to impair United by purchasing stock in American, and that these dual directors would thereby ruin United and American and Sabo himself.

A more reasonable assumption is that Dr. Sabo was duly concerned for the safety of his $115,000.00 investment, and that had he known or suspected what was about to occur, he would have made every possible effort to prevent it, if only for his own financial interests.

Appellees' chain of reasoning breaks down with the very first link. The telegram does not describe a transaction which is prima facie wrongful or antagonistic to the best interests of United. Certainly the stock of a newly formed corporation such as American has no intrinsic value, but it immediately acquires value when the corporation receives the consideration for which the stock is issued. And no harm is done if the consideration thus received is immediately exchanged for other assets of equal value. In such a situation, value imparts value. This is a perfectly simple concept without which no corporation could ever be capitalized.

The problem in this instance stems from the fact that the transfer of assets from United resulted in the legal impairment of that corporation. This result followed only by reason of the provisions of the Arizona insurance code, under which stock in a new corporation such as American cannot be a proper admitted asset for the balance sheet of an insurance corporation. It is not contended that Sabo and Pegram knew of this legal provision, or that they knew that United had insufficient surplus to make such an investment in non-admitted assets. This fact, which of course is not mentioned in the telegram of October 14, 1957, caused the United stock acquired from Kelly to lose its value, with the ultimate effect of rendering United's investment worthless. This is a result that simply does not follow, and is not reasonably to be anticipated, from the statements in the telegram seen by Sabo and Pegram.

The second link in Appellees' reasoning is that the fact that the offer was to be made to United by American must necessarily signify that United was then in the hands of pirates. The logic of this proposition escapes us. It is equally reasonable to suppose that United was being administered by responsible directors who, upon examining the proposal, would simply reject it.

Finally, there is no logical basis for the conclusion, that, if antagonistic persons were in control of United, those persons were the respected associates of Sabo and Pegram. Nothing in their prior conduct or in the telegram itself would suggest this possibility. Appellees' chain of inference from Exhibit 101 is without support in logic, law, or in the evidence.

Acknowledging this Exhibit to be the sole direct evidence of the information communicated to Sabo and Pegram prior to October 18, 1957, regarding the impending transaction

with United, the Supplemental findings based upon what Sabo and Pegram knew or should reasonably have known on that date are clearly erroneous and must be set aside.

This, then, is the sum and substance of the evidence relied upon by Appellees to support the challenged findings as to the knowledge, actual or inferable, of Sabo and Pegram on October 18, 1957. The burden of proof on these issues fell upon Appellees. Appellees' failure to comply with the rules of this Court lends additional substance to our contention that the challenged findings are without support in the record.

4. Neither Sabo nor Pegram Is Liable to United as a Director of American on October 18, 1957, for:

a. Knowing Participation with Fiduciaries in the Breach of Fiduciary Duties (Referring to Pages 87 through 97 of Appellees' brief);

b. Negligence in Failing to Supervise the Activities of the Other Officers and Directors of American on That Date (Referring to Pages 97 through 102 of Appellees' brief).

Irving Trust Co. v. Deutsch, CA N.Y., 73 F.2d 121 (1934), remains the leading exposition of the doctrine applying to corporate directors, or those who conspire with them, liability for participation in the breach of a trust. Appellees have urged that our construction of the decision in *Irving Trust Co. v. Deutsch* is incorrect, and that a proper reading of the principles therein set forth justifies the imposition of liability upon Sabo and Pegram. Rather than re-argue the substance of that decision, we shall leave further analysis of *Irving Trust* to the Court, if it be deemed necessary. We stand upon our interpretation of the decision, as set forth at Pages 33 through 38 of our opening brief herein. Actual participation, knowledge, and profit are indispensable elements in an action to impose liability under this theory. Appellees have not seriously contro-

verted this construction. Rather, they have attempted to infer knowledge from the telegram (Exhibit 101) and to infer participation from the fact that Sabo's money was used (and lost) in the same transaction.

The real question posed by Appellees' discussion of this point is whether the telegram itself gave Sabo and Pegram notice that a breach of trust was contemplated. As we have previously noted, Appellees have asserted that the knowledge imparted to Sabo and Pegram by the telegram—that American was to issue stock to United for assets which were in turn to be used by American to purchase stock in United—must have alerted them to the fact that something improper was about to take place. All of Appellees' analysis of the evidence is necessarily premised upon this assumption.

We do not contend that Sabo and Pegram had any understanding other than that the assets of United, received in exchange for American stock, would serve as the purchase price for the stock interest in United to be acquired by American. The position of Sabo and Pegram is, however, that this fact in itself imports no evil intent and no grounds for suspicion that a disaster was about to occur. There is nothing patently wrongful about a transaction in which one corporation, newly formed, issues its stock to an existing corporation in consideration for valuable assets of that corporation, and then exchanges these assets for a controlling stock interest in the latter corporation. We have discussed this matter in the preceding section of this brief, and we shall not belabor the point further.

Appellees have asserted that we have not related our discussion of the *Irving Trust* decision to the facts of this case. Therefore, to dispel any doubts which may remain, our position regarding the four elements of liability is set forth as follows:

1. *Actual participation with the unfaithful fiduciary.* The conduct of Sabo and Pegram in taking no action after the receipt of the telegram of October 14, 1957, does not constitute participation in the breach of trust. The fact that Niesz, Croydon, and Ballantyne gave Sabo's money to Kelly, along with the United assets, would justify denominating him as an additional victim, rather than as a participant in the breach.

2. *Knowledge that the co-participants owe a fiduciary duty.* As we have repeatedly urged, there is no suggestion, other than in the unsupported arguments made by Appellees, that Sabo and Pegram had any knowledge that those with whom they were associating in American (Niesz, Croydon, and Ballantyne) would occupy a fiduciary relationship to United at any time relevant to the transaction described in the telegram of October 14, 1957.

3. *Knowledge that the conduct of the co-participants amounts to a breach of fiduciary duty.* The transaction described in the telegram is not wrongful on its face. Since Sabo and Pegram manifestly did not have knowledge of those additional facts which would have informed them of the hazard to United, this element is also lacking.

4. *Realization of profits by reason of the breach of duty.* One does not incur liability simply by losing money in a transaction in which another is victimized by a fiduciary. On Page 95 of their brief, Appellees state:

> "* * * Sabo obtained 35.149% of the stock of United from Kelly, worth $325,136.48 (R. 236) through his corporation American, as did Pegram, for an investment of only $52,000. which he had sent to American."

This statement alone contains at least four clear misstatements of fact. First, Sabo did not obtain the stock; it was acquired by American, in which United had a large stock

interest. Second, the stock was not worth $325,136.48; if it had been, no one would have been hurt; it is only the finding that this stock was worthless which justifies the conclusion that United was injured. Third, American was not Sabo's corporation; he was one of several stockholders therein, including United. Fourth, Sabo had invested $92,000.00 by October 18, 1957, and $115,000.00 by October 28, 1957, all of which was lost as a result of the wrongful acts of Niesz, Croydon, Ballantyne, and Kelly.

Applying the law, as expounded in *Irving Trust Co. v. Deutsch,* to the facts shown by the record, it is clear that Sabo and Pegram can not be held liable for knowing participation in the breach of fiduciary duties which occurred on October 18, 1957.

b. Appellees have repeatedly claimed that Sabo and Pegram may be held liable for the acts of Niesz, Croydon, and Ballantyne, either on grounds that the knowledge of the Arizona associates may be imputed to those in Montana, or upon the theory that Sabo and Pegram are legally responsible for failing to supervise those acts of the officers of American occurring between the time of the formation of American at 4:45 P.M., October 17, 1957, and the time the assets of United were turned over to Kelly at 5:00 P.M., October 18, 1957.

In response to these contentions, we have urged:

1. Knowledge of one director can not be imputed to another for purposes of holding the latter liable for an injury caused by the corporation (Argued at Pages 38 through 44 of our opening brief).

2. A director can not be held liable to one injured by his corporation through the negligence of the officers or agents of the corporation, unless the director himself actually caused or participated in the wrong as an individual;

in such event he is held liable for his own wrongdoing, not because of his status as a director (Argued at Page 44 of our opening brief herein, and at Pages 67 through 75 of our opening brief and No. 17114).

c. When a corporate act involving difficult questions of law has been carried out under the supervision of qualified attorneys, reliance upon advice of counsel is a good defense to an action against the directors for damage resulting from the illegality of the act (argued at Pages 45 through 48 of our opening brief).

Appellees' answer to the first and second of these points, as set forth at Pages 97 through 100 of their brief, is simply to beg the question by asserting that Sabo *did* have prior or contemporaneous knowelge of the events of October 18, 1957, and that he *did* actually participate therein. If this were so, then Appellees would be entirely correct in their assertions that the authorities which we have cited are inapplicable. All of these decisions are cited solely for the proposition that directors of a business corporation are responsible to third parties only for their own actions or knowledge, and these authorities have no relevance whatever to a situation in which the directors affirmatively know of and participate in the wrongful act. However, by taking this position and failing to confront the numerous decisions upon which our arguments are based, Appellees appear to concede that *lacking* actual knowledge of the relevant facts, and *lacking* personal involvement in the improper activities, there is no legal basis for imposing liability upon Sabo and Pegram. The argument of Appellees on these points is directed entirely to the question of what Sabo and Pegram knew or should reasonably have known on October 18, 1957, all of which has been fully considered above.

Appellees have made no showing whatever that Sabo and Pegram can be held liable as directors of American for the

acts of the other officers and directors of that corporation. To the extent that the judgment of the District Court is based upon such a theory, it is clearly against the weight of the evidence, is based upon an erroneous view of the law, and must be reversed.

Finally, there is the question of whether Sabo and Pegram had a right to rely upon the advice and guidance of Arizona attorneys in implementing the transaction described in the telegram of October 14, 1957. In response to our discussion of this issue, Appellees have countered with the argument that this defense is unavailable to Sabo and Pegram because there has been no proof that the transaction was "approved" by attorneys specifically representing United, or by the State Insurance Commission or Securities Division. This of course is true, and we have never made any assertions to the contrary. However, this does not preclude application of *Gilbert v. Burnside,* 13 App. Div. 2d 982, 216 N.Y.S. 2d 430; affirmed 11 N.Y. 2d 960, 183 N.E. 2d 325 (1962), discussed at length in our opening brief at Pages 45 through 48.

A reading of the several decisions in *Gilbert v. Burnside* will show that the issue in that case, with regard to the Defendant directors, was not whether the proposed merger had been *approved* by the attorneys for the adverse parties or by the proper state authorities. Rather, the question was whether these directors, realizing that the pending transaction involved difficult questions of Pennsylvania corporate law, had discharged their duty of care by referring the matter to competent Philadelphia attorneys and relying upon the judgment of counsel in proceeding with the reorganization. The holding of the Appellate Division, upheld by the Court of Appeals, was that the reliance upon counsel under the circumstances was justifiable, even though counsel were ultimately proved wrong. The New York courts thus recog-

nized that there are times when the proper discharge of a director's duty requires him to place his trust in attorneys to determine the proper course of corporate action. Appellees do not deny that the transaction was effectuated under the direct supervision of attorneys purporting to represent all interested parties; or that Sabo and Pegram, as investors and directors in American, were relying upon Goss, the attorney for that corporation, to see that the transfers were properly made; or that Sabo received all of his information regarding the United matter through Landoe, who discussed and interpreted the telegram of October 14, 1957. Of course, Sabo and Pegram did not know, and had no way of knowing, that Goss himself, upon whom they were relying, acted as a director of United to approve the purchase of the American stock.

Although *Gilbert v. Burnside* need not necessarily control this case, its reasoning is persuasive in light of the many factual similiarities. Sabo and Pegram, having relied upon counsel for the proper implementation of this exchange, were not negligent as directors of American.

5. Neither DePinto nor Duhame Is Entitled to Contribution or Indemnity From Sabo or Pegram With Regard to Any Recovery Had Against Them in This Action. (Referring to Pages 37 and 38 of the Brief of Appellant DePinto)

Appellants DePinto and Duhame urged, in their appeal in No. 17114, that they should be entitled to indemnification from Sabo and Pegram for any judgment recovered against them in this action. Their argument is set forth in the opening brief of Appellant DePinto in No. 17114, at Pages 50 through 54, and is answered in our reply brief therein, at Page 17 through 20. The theory then advanced was that although DePinto might be liable in negligence for the losses incurred by United, the Arizona Supreme Court, in *Busy Bee Buffet v. Ferrell,* 82 Ariz. 192, 310 P.2d

817, has recognized a distinction, in proper cases, between "active" and "passive" negligence, and "primary" and "secondary" tort liability. DePinto asserted that this distinction was applicable to him and would justify indemnity in his favor against Sabo and Pegram, in spite of the District Court's finding that no contribution would be allowed among the joint tort feasers.

On remand the District Court again considered this matter upon the identical cross-claims filed by DePinto and Duhame. In its memorandum decision (Tr. 1711), the Court acknowledged *Busy Bee Buffet v. Ferrell,* and held:

> "The crossclaims of DePinto and Duhame are predicated on the contention that their liability, if any, is vicarious and secondary to that of the defendants against whom the cross claims are asserted. The named defendants cite an Arizona case discussing primary and secondary tort liability and authorizing recovery of contribution or reimbursement to those held in the second category from those in the first category. *Busy* Bee Buffet v. Ferrell, 82 Ariz. 192; 310 P. 2d 817. Under the particular facts of this case neither DePinto nor Duhame qualifies as having only secondary liability as defined and applied in the cited decision. Both DePinto and Duhame are found and held to be primary joint tort feasors and may not recover contribution under Arizona law. For these reasons the motion of defendants Sabo, Pegram and Landoe to dismiss the crossclaims of defendants DePinto and Duhame is hereby granted."

The language of the District Court leaves no doubt that the criteria set forth in *Busy Bee* were fully considered, and upon such consideration the Court determined as a matter of fact and of law that neither DePinto nor Duhame is entitled to indemnity or contribution from Sabo or Pegram. The points raised by DePinto in No. 17114 have been fully answered in our reply brief in that appeal and by the

decision of the District Court above quoted. Since no reason is shown why this latter determination should be set aside, the decision of the District Court should be affirmed in this respect, regardless of the ultimate outcome on the other issues.

CONCLUSION: A CRITICAL ANALYSIS OF APPELLEES' APPROACH

All of the findings and conclusions of the District Court, and all of the arguments of the Appellees, turn upon the inter-relationship of knowledge and duty. Throughout this litigation, when we have argued that certain critical facts were not known by Sabo and Pegram, Appellees have responded by stating broadly that the law does not require such knowledge. On the other hand, when we have cited legal authority to the effect that certain duties do not arise when the party affected has no knowledge of the relevant facts, Appellees have peremptorily dismissed such authorities as inapplicable, since, they say, Sabo and Pegram did have such knowledge. In spite of this elusive quality of Appellees' argument, the bald fact remains that we have been shown no evidence to support these factual assertions, and we have been cited to no authorities which fairly dispute our legal contentions. The findings, conclusions, and judgment of the District Court are clearly erroneous and must be set aside with directions to dismiss this action against Appellants Sabo and Pegram.

Respectfully submitted,

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Sabo and Pegram

CERTIFICATION

I certify, that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing is in full compliance with those rules.

GUY C. WILSON